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DEPARTMENT PLEASE PASS TO NSC FOR ADAM STERLING

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TAGS: [ECON](#) [EFIN](#) [HU](#)
SUBJECT: THIS OLD HOUSE: NEW CENTRAL BANK GOVERNOR SIMOR ON
REPAIRS AND REFORMS

Classified By: P/E COUNSELOR ERIC V. GAUDIOSI; REASONS 1.4 (B) AND (D)

¶1. (SBU) Summary: Newly-appointed Governor Andras Simor met with Ambassador Foley March 19 to discuss his priorities for the Central Bank (MNB). He believes the economy is stable and the Bank sound, noting his intention to focus primarily on improving communication with the government, the opposition, and the public. He was broadly supportive of reform, emphasizing the necessity of marshalling the political will to address "Hungary's mentality as well as its monetary policy." We strongly recommend appropriate high-level meetings at Treasury and State during Simor's planned trip to the US April 14 - 15. End Summary.

INFLATION: SO FAR ...

¶2. (C) Responding to Ambassador Foley's question, Simor responded that inflation is "on his mind" but noted that the MNB's analysis had earlier projected an increase due to "one-time factors" including tax increases. He believes the inflation rate will slow in the second half of 2007 and reach the target levels of 3% in 2008, helped considerably by the stabilization of oil prices and the "stronger than expected" performance of the forint.

¶3. (C) Simor could not explain the forint's continued strength, but suggested that it is consistent with regional norms. Hungary's high deficits and current inflation rates place it outside the regional average, but he believes investors still see Hungary in the regional context, viewing "its similarities before its differences." He is generally hopeful that growth will rebound by 2008-09, but admitted that it is still "too early to tell" and that global events would continue to exert a significant impact on the Hungarian economy.

REFORMS: THE RIGHT DIRECTION

¶4. (C) Surveying the GoH's reform program, Simor noted that the government had been "right in the general direction" even though it had been "wrong on hundreds of details." He pointed out that the government still retained sufficient budgetary reserves and sees "no present danger of derailing." He is concerned, however, that the government has focused largely on "one-time measures" that will be politically "hard to sustain" in the longer term. Referring to the referenda put forward by the opposition, he also warned that the government could absorb challenges to individual aspects of the reform agenda but could not afford to "lose them all."

THE CURRENCY BAND: IN THEORY AND IN PRACTICE

¶5. (C) Turning to the GoH's maintenance of a currency band, Simor readily conceded that the band is "not consistent" with

an inflation target regime "in theory," but commented that the band "hasn't hurt us in practice." Any decision regarding the elimination of the band must be taken jointly with the government, and he does not see it "on the agenda" in the near term.

INHERITING A GOING CONCERN

¶16. (C) Detailing his general approach to running the MNB, Simor compared his appointment to inheriting an old house, commenting that "there are some things I would have built differently but can still live with." Among the changes he does anticipate is a new focus on the Bank's communications with both the government and the public. "We can do better," he noted, "without risking our independence," including by informally sharing its experience in forecasting with the relevant ministries. He has taken the same approach to dealing with the opposition, reaching out to both FIDESZ leader Viktor Orban (albeit unsuccessfully) and to Parliamentary faction leader Tibor Navracsics to make clear that he regards the MNB as a truly national institution.

REFORMING THE MENTALITY; IMPROVING ACCOUNTABILITY

¶17. (C) But, he concluded, the public bears a great responsibility as well. The most important aspects of the reform program "address our mentality and not our monetary policy," challenging the deeply-rooted notion of the state as "godfather and not service-provider." He regards the tax system as the most crucial issue facing the government, commenting that "Hungarians expect to be taken care of ... and not have to pay for it." "Tax evasion," he noted wryly, "should not be a point of national pride." He believes the long-term solution lies in "reallocating rather than reducing the burden" by adjusting the balance of taxes on income and assets.

¶18. (C) Even more important, Simor continued, would be the government's commitment to set an example of accountability through enhanced enforcement efforts. Ultimately, he concluded, "the system will not reform itself," and politicians must marshal the political will to address the underlying issues of corruption and party financing. To date, he remarked, they have been "schizophrenic" - knowing what is right but not daring to break with the advantages offered by the status quo. Hungary, he continued, is "famous for taking the right steps ... and then prematurely relaxing the policies when there is some evidence of success" on structural reforms, and he believes the government may come under increasing political pressure to ease up as the 2010 elections approach.

TRAVEL TO THE U.S.

¶19. (SBU) Simor concluded by noting his plans to travel to the US for IMF events April 14 - 15. He warmly welcomed our offer to discuss additional bilateral meetings on the margins, and we recommend that he be received by appropriate senior officials at both Treasury and State.

¶10. (C) Comment: The positive reaction to Simor's appointment reflects confidence in his business experience and his political neutrality. (In response to the Ambassador's question, he felt the reason for the widespread approval from financial observers was based on his "sensible" decision making as a corporate executive.) Both traits were in evidence in our meeting, and we anticipate he will take a measured approach to address the priorities he has correctly identified. End Comment.

FOLEY